

Decision 02-06-067 June 27, 2002

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

In the Matter of the Application of California  
Water Service Company (U 60 W), a Corporation,  
for an Order Authorizing it to Increase Rates  
Charged for Water Service at Each of its  
Operating Districts to Recover Increased  
Operating Expenditures at its General Office.

Application 01-05-002  
(Filed May 1, 2001;  
amended August 15, 2001)

Gregory Bowling, Attorney at Law,  
and Francis S. Ferraro, for California  
Water Service Company, applicant.  
Laura Tudesco, Attorney at Law,  
for the Office of Ratepayer Advocates,  
and James Weil, for Aglet Consumer  
Alliance, interested parties.

**O P I N I O N**

**I. Summary**

California Water Service Company (CWS) requests authority to increase rates in each of its operating districts to recover increases in its General Office (GO) revenue requirement. By this decision, we deny the application because CWS has not demonstrated that the GO revenue requirement should be treated separately from general rate case (GRC) proceedings.

## II. Background

On May 1, 2001, CWS filed this application to increase rates in each of its operating districts to recover a projected increase in its GO revenue requirement. At the July 10, 2001 prehearing conference, the assigned administrative law judge (ALJ) ordered CWS to amend its application to fully satisfy the Commission's requirements for such a filing. The amendment was filed on August 15, 2001. Hearings were held on January 17 and 18, 2002. The proceeding was submitted upon receipt of briefs.

## III. The Application

In its application, CWS requested approval of rate increases for its operating districts to recover its estimated GO revenue requirement increases for 2001 and 2002. CWS proposed that the increases be implemented through advice letter filings. The requested revenue requirement increases for each of its operating districts are as follows:

<u>District</u>	<u>2001 (\$)</u>	<u>2001 (%)</u>	<u>2002 (\$)</u>	<u>2002 (%)</u>
Bakersfield	673,300	2.8	204,200	0.8
Bear Gulch	330,800	2.7	87,400	0.7
Chico	427,200	5.7	85,500	1.1
Dixon	31,000	3.2	10,000	1.0
East Los Angeles	404,000	2.6	114,100	0.7
Hermosa-Redondo	498,000	3.4	104,100	0.7
Livermore	330,400	4.1	63,800	0.8
Los Angeles	501,000	4.8	73,400	0.7
Marysville	54,300	4.3	13,500	1.0

Palos Verdes	307,400	1.5	128,000	0.6
Salinas	724,600	9.3	89,600	1.1
Mid Peninsula	517,500	3.3	118,600	0.7
South San Francisco	197,600	2.5	59,800	0.8
Stockton	542,000	3.6	139,100	0.9
Visalia	309,800	3.6	90,800	1.0
West Lake	103,600	1.5	46,800	0.7
Willows	24,700	3.0	9,200	1.1

#### **IV. Proposed Settlement**

On December 14, 2001, CWS and Aglet Consumer Alliance filed a motion to adopt a proposed settlement. Under the settlement, CWS would be allowed a \$3,000,000 annual rate increase for 12 months from the date of the increase, or until the effective date of a decision in Application (A.) 01-09-062, et al.<sup>1</sup> No increases would be allowed for the Bakersfield, and South San Francisco Districts. However, CWS would be allowed to request rate increases for those districts effective January 1, 2003, up to a specified maximum, by advice letter. The Office of Ratepayer Advocates (ORA) opposed the motion.

#### **V. Positions of ORA and CWS Regarding Treatment of GO Revenue Requirement Outside of GRCs**

ORA argues that the application should be denied because it does not meet the requirements for consideration of a category of expense outside the context of

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<sup>1</sup> A.01-09-062, et al., are general rate increase applications which include the CWS districts involved in this application with the exception of the Bakersfield, Palos Verdes, and South San Francisco Districts.

a GRC. In particular, ORA says that the Commission's established practice is to consider GO expenditures in general rate proceedings. In addition, ORA says that CWS has been over-earning for the last five years, and that for the 12 months ending September 30, 2000, CWS was earning a return of 10.21% on a company-wide basis as opposed to an authorized return of 8.79%.

CWS argues that the Commission's water Rate Case Plan (RCP) allows for the filing of rate applications outside of the RCP. As to earnings, CWS says that earnings for 1997-2001,<sup>2</sup> unadjusted for weather or other ratemaking items, exceeded authorized earnings by only \$4.9 million. CWS also states that the proposed increases in its application and the settlement were subjected to a pro forma earnings test to insure that the increases for each district would not result in earnings above the authorized rate of return.

## **VI. Discussion**

The Commission sometimes allows water utilities to recover recorded costs for purchased power, purchased water, and pump taxes through "offset" proceedings, filed by advice letter, to the extent that these are unforeseen expenses that are beyond the control of the utility, and are recorded in Commission-authorized balancing accounts. Here, the requested increase has not been approved for recovery through offset proceedings, and was not filed by advice letter. The expenditures are projected rather than recorded, they are within the control of the utility, and they are not recorded in balancing accounts. Therefore, this is not an offset proceeding.

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<sup>2</sup> 2001 is an estimate based on nine months of data.

Traditionally, the GO revenue requirement is addressed in GRC proceedings for the operating districts.<sup>3</sup> The GO revenue requirement is estimated for the total company, and allocated to the operating districts. In this way, all elements of each district's revenue requirement are examined, and rates are set accordingly.

In this proceeding, CWS asks us to increase rates to recover its estimated GO revenue requirement outside of the operating district GRCs. CWS says that its request is consistent with the RCP that provides that "Class A water utilities may file general rate case applications at times other than those provided in the filing schedule..." Decision (D.) 90-08-045: 37 CPUC 2d 175,188 (1990). It also says that there is no Commission decision that says the GO revenue requirement can only be reviewed in GRC applications for operating districts. These assertions miss the point, and do not support increasing the GO revenue requirement in a separate proceeding, apart from a GRC. The issue is not whether CWS can request rate increases for estimated GO expenses outside of district GRCs, but whether the request should be granted. As explained below, the GRC is the proper forum for setting the utility's revenue requirements, and CWS has not justified doing otherwise in this proceeding.

In GRCs, each district's revenue requirement is reviewed in its entirety, and the resulting rates are set to allow the utility an opportunity to earn a reasonable rate of return. Over time some expenditures that make up the

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<sup>3</sup> CWS files GRCs for some of its districts every year. In recent years, CWS and ORA have informally agreed to examine the GO revenue requirement every third year. In GRCs filed for the intervening years, the previously adopted GO revenue requirement, adjusted for inflation, has been used.

revenue requirement may increase while others may decrease. The Commission considers the resulting risk to the utility's earnings in setting the authorized return on equity. Since the utility is at liberty to manage its operations, it can increase its earnings by controlling costs. In this proceeding, CWS asks that we adjust rates for the operating districts, by looking only at the GO revenue requirement allocations, without looking at other costs that may also have increased or decreased. Were we to do so, in the absence of a review of its overall operating costs, we would be reducing the risk to the utility's earnings, and the resulting incentive for the utility to be efficient. Stated differently, were we to allow the utility to adjust its revenue requirements on a piecemeal basis, it could seek rate increases whenever its costs were going up, while ignoring expense categories where costs were unchanged or decreasing. Over time, such a practice could result in unnecessarily high rates.

In its recent GRC applications for its operating districts, CWS has been authorized rate increases for two test years and two attrition years.<sup>4</sup> These increases are intended to compensate CWS for net increases in its revenue requirements over the covered years, including the GO. Therefore, the fact that CWS estimates that its GO revenue requirement will increase does not justify adjusting rates outside of district GRCs.

While CWS and ORA disagree on how much CWS' earnings exceeded authorized earnings in recent years, neither party alleges that CWS is

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<sup>4</sup> For test years, rates are set based on individually estimated expenditures. For attrition years, rates are adjusted by an overall escalation factor.

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experiencing a financial emergency. Therefore, there is no financial emergency to justify the proposed rate increases.

CWS has pending GRC applications for most of its operating districts. The GO revenue requirement will be more fully examined in those proceedings. In addition, in D.01-08-039 and D.01-09-003, the Commission approved a settlement that adopted GRC rate increases for the Bakersfield and South San Francisco districts. Therefore, we find that CWS has ample opportunity to seek recovery of GO revenue requirement increases through GRC proceedings for its operating districts.

CWS has not justified its proposal to increase rates in its operating districts to recover its estimated GO revenue requirement increases outside of operating district GRCs, and there is no precedent for doing so.<sup>5</sup> Since, as CWS pointed out, D.90-08-045 does not preclude it from filing operating district GRCs outside of the RCP, it could have filed its GRCs earlier. Therefore, we see no reason to allow consideration of the GO revenue requirement outside of the operating districts' GRCs. Since the settlement would grant rate increases for estimated GO revenue requirement increases outside of GRCs, and we see no reason to do so, it is not in the public interest. As a result, we will deny the motion for approval of the proposed settlement, and dismiss the application.

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<sup>5</sup> In D.98-12-070, the Commission approved a settlement that allowed Southern California Water Company to recover agreed-upon GO revenue requirement increases through advice letter filings for districts that were not part of the GRC applications. In D.99-05-018, the Commission approved a settlement that granted a similar request by CWS. Pursuant to Rule 51.8 of the Commission's Rules of Practice and Procedure, however, such settlements are not precedential.



## **VII. Categorization and Need for Hearings**

In Resolution ALJ 176-3063 dated May 14, 2001, the Commission preliminarily categorized this application as ratesetting, and preliminarily determined that hearings were necessary. Since hearings were held, there is no reason to disturb this preliminary determination.

## **VIII. Comments on the Proposed Decision**

On April 16, 2002, the principal hearing officer's draft decision (DD) in this proceeding was filed with the Commission and served on the parties in accordance with § 311(d) of the Pub. Util. Code and Rule 77.1 of the Commission's Rules of Practice and Procedure. Comments were filed by CWS, and Aglet opposing the DD. ORA filed comments in support of it.

In its comments on the DD, CWS repeats a number of arguments it has previously made. However, it does make several additional arguments that should be addressed. CWS argues that there is precedent for adjusting rates outside of GRCs. It cites an instance where an additional attrition year was granted because of a delay in the GRC schedule. It also cites cases where rates have been adjusted for recovery of costs incurred as a result of earthquakes, ratebase offsets, and regulatory treatment of hazardous wastes, as well as offset proceedings. The DD does not say that rates cannot be adjusted outside of GRCs. What the DD says is that CWS has not justified increasing rates for forecasted GO expenditures outside of GRCs in this proceeding, and there is no precedent for doing so.

CWS contends that the DD ignores the fact that CWS applied a pro forma earnings test in its application to protect against potential over-earnings. Application of the test resulted in reduction of the request for four districts, and exclusion of other districts from the application. It also says that the settlement

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applies an earnings limit to individual districts based on recorded earnings. The fact that the requested rate increases had to be reduced or eliminated to prevent over-earnings, and that earnings limits were included in the settlement do not support the need for rate increases. In fact, they tend to support the DD's conclusion that the proposed rate increases are not justified.

CWS and Aglet argue that the DD fails to address the issue of regulatory lag. They say that decisions approving recent rate increases have been delayed for several months. The fact that CWS stated that its earnings for 1997-2001, unadjusted for weather or other ratemaking items, exceeded authorized earnings by \$4.9 million, that it applied an earnings test in its application to prevent over-earnings, and that the settlement has an earnings limit, tend to indicate that CWS has not suffered unduly from regulatory lag.

CWS contends that the DD fails to properly analyze the settlement since it did not specifically analyze whether the settlement is reasonable in light of the whole record, consistent with law and in the public interest. For a settlement to be approved, it must satisfy all three requirements. If it fails to satisfy any one of the requirements, it cannot be adopted. Since we find that no rate increase should be granted, it cannot be in the public interest to grant one. Therefore, the settlement, which grants one, is not in the public interest. Having failed the public interest requirement, the settlement cannot be adopted whether or not the other requirements are met.

Aglet says that the DD unfairly dismisses the application. It argues that the Commission had the information that the DD relies on early in the proceeding, and should have dismissed the application then if it intended to do so. Aglet's argument does not justify approval of the settlement Aglet supports. In addition, it faults the ALJ for developing a full record before preparing the

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DD. We do not see how providing parties a full opportunity to be heard disadvantages them. In addition, developing a full record provides the Commission with the opportunity to consider whether it should adopt a result other than the DD without the need for additional hearings, and the delay that would result.

### **Findings of Fact**

1. The Commission has not previously authorized recovery of the GO revenue requirement through offset proceedings.
2. The GO revenue requirement is projected rather than recorded, within the control of the utility, and not recorded in a balancing account.
3. Traditionally, the GO revenue requirement has been addressed in GRC proceedings for operating districts where it is estimated for the total company, and allocated to the operating districts.
4. In GRC proceedings, all elements of each district's revenue requirement are examined, and rates are set accordingly.
5. CWS files GRCs for some of its districts every year.
6. In recent years, CWS and ORA have informally agreed to examine the GO revenue requirement every third year.
7. In the intervening years, the previously adopted GO revenue requirement, adjusted for inflation, has been used.
8. In GRCs the Commission considers the risk to the utility's earnings in setting the authorized return on equity.
9. Since the utility is at liberty to manage its operations, it can increase its earnings by controlling costs.

10. If the Commission were to adjust rates for the operating districts, by looking only at the GO, the incentive for the utility to be efficient would be reduced.

11. CWS is not experiencing a financial emergency.

12. CWS has pending GRC applications for most of its operating districts.

13. In D.01-08-039 and D.01-09-003, the Commission approved a settlement that adopted GRC rate increases for CWS' Bakersfield and South San Francisco districts.

14. There is no precedent for granting CWS' request to increase rates in its operating districts to recover its estimated GO revenue requirement increases outside of operating district GRCs.

15. D.90-08-045 does not preclude CWS from filing operating district GRCs outside of the RCP.

16. The settlement would grant rate increases for estimated GO revenue requirement increases outside of GRCs.

### **Conclusions of Law**

1. This application is not an offset proceeding.

2. CWS has ample opportunity to seek recovery of GO revenue requirement increases through GRC proceedings for its operating districts.

3. CWS has not justified its proposal to increase rates in its operating districts to recover its estimated GO revenue requirement increases outside of operating district GRCs.

4. The settlement is not in the public interest.

5. The motion of CWS and Aglet for approval of a proposed settlement should be denied.

6. The application should be dismissed.

7. In order to remove this matter from the Commission's calendar, this order should be effective immediately.

**O R D E R**

**IT IS ORDERED** that:

1. The motion of California Water Service Company and Aglet Consumer Alliance for approval of a proposed settlement is denied.
2. Application 01-05-002 is dismissed.
3. This proceeding is closed.

This order is effective today.

Dated June 27, 2002, at San Francisco, California.

LORETTA M. LYNCH  
President  
HENRY M. DUQUE  
CARL W. WOOD  
GEOFFREY F. BROWN  
MICHAEL R. PEEVEY  
Commissioners